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DEPARTMENT FOR EUR/AGS AND EB/OIC

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SUBJECT: German Real Estate Corruption Scandal Implicates
Major Investment Funds

REF: Frankfurt 2923

Sensitive but unclassified; not for internet distribution

1. (SBU) SUMMARY: Frankfurt prosecutors will soon issue corruption indictments against fund managers, architects, and builders in a series of large real estate deals across Germany. The alleged corruption includes bribes and a number of transactions in which participants pocketed bogus commissions from fictitious agents. The manager of Germany's largest real estate fund and a prominent banker are under arrest and are cooperating with police. More than forty persons are under investigation in a case involving more than a dozen real estate projects throughout Germany. The scandal could seriously damage the credibility of German real estate funds (managing nearly 70 billion euros in public investment) and deal another blow to a weak construction market. END SUMMARY.

2. (U) Frankfurt prosecutors are investigating a major corruption scandal involving leading real estate fund managers. The investigation began in 2002 with a corruption case against a Deutsche Bank real estate manager, who disclosed information concerning a major project in Frankfurt -- the Investment Banking Center (IBC) -- and claimed bribes in a "six-digit range" were paid to secure building contracts. The manager of Deka Bank's real estate fund (Germany's largest retail fund in the sector) was fired last week for "irregularities" and then began to cooperate with Frankfurt prosecutors. Another fund manager disclosed information leading to three other cases. The weekly magazine FOCUS (right-of-center with a circulation of around 770,000) cites alleged corruption in a dozen other projects across Germany.

3. (SBU) Frankfurt chief prosecutor Wolfgang Schaupensteiner -- one of Germany's leading crusaders against corruption -- stated publicly that although he cannot estimate the damage to investors and shareholders, the indictments will break "new ground" in their scale. The deals share a similar pattern of corruption: in the final stages of a transaction, participants bring in a fictitious real estate agent and divide the commission among all parties. In an earlier meeting with consulate representatives (reftel), Schaupensteiner expressed concerns about his office's limited resources to pursue complicated cases such as this one.

4. (U) The indictments may have an impact well beyond the tainted firms and individuals. Bankers and fund managers -- already struggling with a depressed building market -- worry the scandal will damage the credibility of real estate funds. The German Financial Supervisory Authority (BAFIN) has launched an investigation into damage to investors. Critics are using the scandal to question the viability of major construction projects financed by real estate funds, including the 450 million euro IBC building constructed for (but never occupied by) Deutsche Bank.

5. (SBU) COMMENT: Although the full scale of corruption is unclear, more arrests are certain and the scandal appears to rank among the largest in Germany's recent history. The ultimate damage could be greater to the extent that the scandal undermines the credibility of popular real estate funds. According to the Bundesbank statistics, real estate funds open to the general public have 68.7 billion euros under management. Contacts in the banking community speak of a "grenade detonating" under an already weak market for new construction. END COMMENT.

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